SUPREME COURT, U. S.

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1967

No. 652

GEORGE M. BARD, RALPH A. BOGAN, JR., EDWARD O. BOSHELL, M. M. HARDIN, HERBERT F. KORHOLZ, J. PATRICK LANNAN, HOWARD J. LAUHOFF, A. D. MARTIN, HAROLD G. MASON, J. EARLE MAY, HUGH C. MICHELS, AKSEL NIELSEN, D. W. REEVES, R. C. SCHENK, FRANKLIN B. SCHMICK, HAROLD C. STUART, ALBERT W. THOMSON, ARTHUR M. WIRTZ and FRANCIS C. WOOLARD, *Petitioners,*

v.

WILLIAM DASHO, DASHO-ROGERS, INC., an Illinois corporation, and MAURICE H. SCHY, *Respondents.*

PETITIONERS' BRIEF IN REPLY TO RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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PRELIMINARY STATEMENT

The substantive reasons advanced by Respondents for the denial of the Petition in this case are related only to the first of the Questions Presented in the Petition. The remaining Questions are challenged as not in accord with Rule 23-1(c). Although we shall later advert briefly to that challenge, this reply brief will primarily concern itself with Respondents' comments on the status of federal law bearing on the first Question.

The first Question, as set forth in the Petition (Pet. 2), is whether, as a matter of interpretation of the federal

securities laws, a statutory merger involves a sale by the merged corporation or a purchase by the surviving corporation, and, if so, whether the complaint states a cause of action under those laws.* Respondents (R. Br. 4) argue that this statement of the Question is not expressed in the "terms and circumstances of the case". In thus challenging the Question, Respondents ignore the thrust of the opinion of Judge Fairchild below. His opinion, written also on behalf of Judge Cummings, raised the question whether a statutory merger involves the "sale of the shares or assets of merging corporations" (App. A-10), and concluded that Susquehanna, the surviving corporation, had a cause of action with respect to the "acquisition, by merger", from Gypsum, the merged corporation, of 435,000 Susquehanna shares (App. A-14). Respondents' "restated" question includes the cognate issue which, consistently with Rule 23-1(c), is fairly comprised within Petitioners' first Question and was fully discussed in the Petition (Pet. 9-12), as to whether the surviving corporation in a statutory merger is a "seller" of securities, as well as the related issue whether that corporation is a "purchaser" of securities. Respondents argue, erroneously, that the federal law on both of these issues is "settled". Furthermore, they predicate their "restated" question on the assumption that the allegations of the complaint support the conclusion that, as a matter of federal securities law, fraud was perpetrated on Susquehanna in connection with its assumed "sale" and "purchase" of securities in the merger.

We respectfully submit that the Respondents' brief fails to show that the federal law on any of these issues is "settled".

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* "Pet." refers to the Petition; "App." to the Appendix to the Petition; "R." to the appendix record on appeal lodged with the Clerk of the Court; "R. Br." to Respondents' Brief in Opposition; "Susquehanna" to The Susquehanna Corporation; and "Gypsum" to American Gypsum Co.

STATUS OF FEDERAL LAW ON ISSUES IN "RESTATEMENT" OF FIRST QUESTION PRESENTED

As to Whether, for the Purpose of the Federal Securities Laws, the Surviving Corporation in a Statutory Merger Effects a "Sale" or a "Purchase" of Securities.

In support of their position as to the "settled" status of federal law on the issue of "sale", Respondents cite only *H. L. Green Company, Inc.* v. *Childree,* 185 F. Supp. 95 (S.D. N.Y. 1960) and *Simon* v. *New Haven Board & Carton Company,* 250 F. Supp. 297 (D. Conn. 1966). The *H. L. Green Company, Inc.* case did not involve a statutory merger, but an exchange by the issuing corporation, in an individual transaction, of its stock for stock of another corporation. See *H. L. Green Company, Inc.* v. *MacMahon,* 312 F. 2d 650 (2 Cir. 1962), cert. den. 372 U.S. 928 (1943).

As stated by the court in the 1960 *H. L. Green Company, Inc.,* decision: "[M]erger is not a term of fixed and definite content. A transaction properly so described may or may not involve a purchase and sale within the meaning of Section 10(b) of the Act."* The remaining single decision of the district court in the *Simon* case to the effect that the surviving corporation in what may have been a statutory merger was a "seller" of securities, clearly does not "settle" federal law on this issue.

The Respondents say that the *H. L. Green Company, Inc.* decision, the *Simon* decision and the decision of the court below are "structured on" *Hooper* v. *Mountain States Securities Corporation,* 282 F. 2d 195 (5 Cir. 1960), *Ruckle* v. *Roto American Corporation,* 339 F. 2d 24 (2 Cir. 1964) and *Kane* v. *Central American Mining & Oil, Inc.,* 235 F. Supp. 559 (S.D. N.Y. 1964). It is true that each of these cases held that a corporate issuer of stock to a third party, in an individual transaction, was a "seller" of stock, for

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* 185 F. Supp. 95, 96.

the purpose of Section 10(b) of the Exchange Act and Rule 10b-5 of the Securities and Exchange Commission (the "Commission"). But none of these cases involved a statutory merger, and they clearly do not constitute any determination with respect to the legal issue whether, for the purpose of the federal securities laws, the surviving corporation in a statutory merger is a "seller" of securities.

Furthermore, since neither *Hooper, Ruckle, Kane,* nor *H. L. Green Company, Inc.* involved a statutory merger or consolidation, they are clearly not determinative on the further issue whether such a transaction involves a "purchase" of securities by the surviving company. And no such issue was considered in connection with the transaction before the court in the *Simon* case, *supra,* the only other case relied upon by Respondents as "settling" federal law.

Respondents urge (R. Br. 6-7) that *National Supply Co.* v. *Leland Stanford Jr. University,* 134 F. 2d 689 (9 Cir. 1943), cert. den. 320 U.S. 773 (1943), discussed in the Petition (Pet. 10-12), is not germane to the issues here involved, and that the Commission's narrow application, adopted by the court below, of the "no-sale" theory expressed in Rule 133 as to statutory mergers (17 C.F.R. § 230.133 (1967)), is not in conflict with that decision. This is simply not so. It is true that, in reversing the District Court's decision in favor of a stockholder who challenged a statutory consolidation, the Court of Appeals found laches. However, after pointing out that the findings of the District Court had indicated "the belief that appellee has causes of action under both § 12(1) and § 12(2) of the [Securities] Act",* the court also expressed unequivocally its concurrence with the views of the Commission in its "exhaustive brief amicus curiae", to the effect that the "civil liability provisions of the Act have no application".**

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* Section 12 (15 U.S.C. § 77*l*), as then in effect, is set forth in the Appendix to this brief.

** 134 F. 2d 689, 694.

In summarizing the three civil liability provisions of the Act, the Commission had pointed out that two were relevant, i.e., clause (1) of Section 12, imposing liability upon a person who "sells" unregistered securities, and clause (2) of that section, imposing liability upon a person who "sells" securities by means of misrepresentations or material omissions of fact.* Referring to the causes of action asserted by the plaintiff under each clause, the Commission pointed out that "if there is no 'sale' under the statutory definition, there can be no cause of action under either Section 12(1) or Section 12(2)," and concluded that in a statutory consolidation or merger no sale occurs. The Commission's subsequent interpretation of the Act implicit in Rule 133 and related releases, to the effect that, despite identical pertinent text, a statutory consolidation or merger involves a "sale" of securities for the purpose of clause (1), but not for the purpose of clause (2), is in clear conflict with the Court's decision and the position of the Commission in the *National Supply Co.* case.

As to Whether the Allegations of the Complaint Support the Conclusion That, as a Matter of Federal Securities Law, Fraud Was Perpetrated on the Surviving Corporation in Connection With Its Assumed "Sale" or "Purchase" of Securities in a Statutory Merger.

The first Question, as "restated" by Respondents, is bottomed on the assumption that alleged deficiencies in proxy materials relating to Susquehanna's annual meeting, and certain statements made at that meeting, held in April, 1965, involved a "fraud" on the corporation within the meaning of Section 10(b) of the Exchange Act "in connection with" its "sale" and "purchase" of securities in the merger which occurred eight months later. This assumption is made despite the requisite vote of stockholders obtained on the basis of a subsequent proxy state-

* The third provision (Section 11; 15 U.S.C. § 77k) imposes civil liability only for registration-statement deficiencies.

ment relating to the merger which was held by the District Court to be fully informative,*—a conclusion not questioned by the Court of Appeals.

Alleged deficiencies in the proxy materials for the annual meeting, which was concerned only with the election of directors, constitute the crux of the "fraud" on which the action is based. The position of Petitioners is that since such deficiencies, if any, even if actionable under state law, involved matters of corporate management and were not made "in connection with the purchase or sale of securities",** they were not actionable under Section 10(b) of the Exchange Act.

The case at bar thus differs from *Ruckle* v. *Roto American Corporation,* 339 F.2d 24 (2 Cir. 1964), which was relied upon by the appellate court below. In that case, the court held that the failure or refusal of a majority of a board of directors of a corporation to disclose to the remaining directors material data relevant to the corporation's financial condition and to the consideration to be received by the corporation for stock to be issued by it, constituted a "fraud" on the corporation in connection with the "sale" of such stock, and hence gave rise to a cause of action in favor of the corporation under Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

Petitioners' view that *Ruckle* does not "settle" the law in the case at bar is supported by the subsequent but substantially concurrent decision of the same court in *O'Neill* v. *Maytag,* 339 F. 2d 764 (2 Cir. 1964), which the majority of the court below considered but refused to follow. There, despite the contrary views expressed by the Commission in its amicus curiae brief, the court held that no cause of action arose under Section 10(b) of the Exchange Act in favor of a corporation, where it was alleged that its directors approved the acquisition by the corporation of a sub-

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* App. 36-37; 52-53.

** Section 10(b) prohibits the use or employment of manipulative or deceptive devices *"in connection with the purchase or sale"* of securities involving the requisite jurisdictional facilities, in contravention of rules promulgated by the Commission (15 U.S.C. § 78j(b)). [Emphasis supplied]

stantial block of its shares at an excessive price, in order to eliminate the threat to their control posed by the continuing concentrated ownership of such shares. The court distinguished *Ruckle* on the ground that in that case there had been a "clear allegation of deception in connection with the sale of securities",* whereas in the case then before it the question was whether the duty allegedly breached was "only the general duty existing among corporate officers, directors and shareholders".** The court pointed out, as it had previously stated in *Birnbaum* v. *Newport Steel Corp.*, 193 F. 2d 461, 464 (2 Cir. 1952), cert den. 343 U.S. 956 (1952), that Section 10(b) and Rule 10b-5 were "directed solely at that type of misrepresentation or fraudulent practice usually associated with the sale or purchase of securities rather than at fraudulent mismanagement of corporate affairs." Although it recognized the difficulties which might be involved in drawing this line, the court held that such difficulties do not justify "treating the section or the rule as a mandate to inquire into every allegation of breach of fiduciary duty respecting the issuance or sale of corporate securities". *** The nature of the problem posed by *Ruckle*, *Maytag* and the case at bar has been well stated by Arthur Fleischer, Jr., former Executive Assistant to the Chairman of the Commission:

> "In sum, the implications of *Maytag* and, to some extent, *Ruckle* are unclear. On one hand, they may be taken to stand for the proposition that the only form of deceit that will sustain an action under the securities acts is that which affects the financial judgment of an investor. But on the other, the cases may stand for the proposition that an allegation of less than complete disclosure with regard to any aspect of any securities transaction will support a federal claim. "If the second reading should prove to be correct, it

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* 339 F. 2d 764, 768.
** 339 F. 2d 764, 767-768.
*** 339 F. 2d 764, 768.

would involve the federal courts in working out federal rules to govern every aspect of corporate behavior that involves securities. This would be unfortunate.'"*

The "second reading", posed by Mr. Fleischer, of the implications of *Maytag* and *Ruckle* is assumed by Respondents in their "restatement" of the first of the Questions Presented in the Petition.** The adoption of any such reading would involve the resolution of a major unsettled issue of interpretation and application of the federal securities laws which merits the consideration of this Court.

REPLY TO RESPONDENTS' OBJECTIONS TO OTHER QUESTIONS PRESENTED

Having considered Respondents' comments on the status of federal law with respect to the first Question, we shall now comment briefly on their challenge of the remaining Questions as not in accord with Rule 23-1(c).

The second Question (Pet. 2) was whether Respondents, as shareholders of Susquehanna, were, within the federal securities laws, purchasers of securities, despite no change in share-ownership. The question was so framed, since the complaint (Para. 1, R. 5) alleged that the action was brought not only on behalf of Susquehanna but on behalf of the

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* Fleischer, "'Federal Corporation Law': An Assessment," 78 Harv. L. Rev. 1146, 1166.

** In its opinion of June 28, 1966, the District Court, referring to its earlier opinion of April 15, 1966, considered and rejected such a "second reading", stating (R. 52-53):

> "In that decision, we held that the only possible sale in issue, if one was present at all, took place at the time of merger, and accordingly directed our attention solely to misstatements or omissions which may have directly influenced consummation of that act. * * * * We are not concerned with the election of directors, but only with the material facts going to the approval of the merger itself."

We regret that the District Court's second opinion, reported at 267 F. Supp. 513, was erroneously referred to at page 2 of our Petition as appearing at page 39, rather than page 46, of the appendix record on appeal.

plaintiffs and all other shareholders similarly situated. Since the Respondents now recognize that the action is solely a derivative action on behalf of Susquehanna and does not involve the issue whether the plaintiffs themselves were purchasers of securities, the second Question need not be considered.

As to the third and fourth Questions (Pet. 3), Petitioners submit that, in considering whether, as Respondents allege, the merger of Gypsum into Susquehanna was the culmination of a conspiracy in violation of the federal securities laws, it would be relevant for this Court on review to consider whether two "overt acts" alleged to be essential parts of the conspiracy were themselves in violation of any such laws. Respondents' further challenge of the fourth Question, as not within Rule 19 of the Court, erroneously confuses the considerations governing the exercise of the Court's discretion in granting certiorari, as stated in Rule 19, with the requirements of Rule 23-1(c) as to the statement of questions presented for review.

Respondents' challenge of the fifth Question (Pet. 3) as not "expressed in the terms and circumstances" of the case, is unwarranted. It presumably stems from the fact that, as stated in the amendment to the complaint filed on November 12, 1965, the merger at that date had not yet been consummated and the proxy-soliciting material relating to the proposed merger, although then on file with the Commission, had not yet been sent out (Para. 26, R. 20).

However, both the District Court and the Court of Appeals recognized, as the record* shows, that at the time of the District Court's first decision, on April 15, 1966, such proxy-soliciting material had gone out and the merger had been consummated. The related proxy-soliciting material, as to which there was no "factual question" (R. 53), which

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* The District Court stated in its first opinion: "Plaintiffs were fully informed of the details of which they complain before the merger was consummated * * * and were free to invoke their rights of appraisal at the time of the merger". (R. 37).

was found by the District Court to provide full disclosure (R. 35-37; 52-53), was filed by Respondents in the Court of Appeals, and is a part of the record lodged with this Court.

CONCLUSION

Respondents have failed to set forth sufficient grounds for denying the Petition. If the Petition is granted, Petitioners, for reasons given in this reply brief, would deem it appropriate to eliminate the second Question presented by the Petition.

Respectfully submitted,

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November 21, 1967

APPENDIX

SECTION 12 of Securities Act of 1933 (15 U.S.C. § 77*l*), as in effect prior to August 10, 1954:

§ 77*l*. Civil liabilities arising in connection with prospectuses and communications.

Any person who—

(1) sells a security in violation of section 77e of this title, or

(2) sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

Note: This Section was amended in 1954 by the insertion of the words "offers or" before the word "sells" in clauses (1) and (2).